

# FISCAL NOTE

**Bill #:** SB0407      **Title:** Income tax reduction with revenue from limited sales tax

**Primary Sponsor:** Depratu, B      **Status:** As Amended House Taxation Committee on April 9, 2003

Sponsor signature	Date	Chuck Swysgood, Budget Director	Date
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## Fiscal Summary

	FY 2003	FY 2004 <u>Difference</u>	FY 2005 <u>Difference</u>
<b>Expenditures:</b>			
General Fund	\$4,188	\$40,573	\$41,572
State Special Revenue	\$411,175	\$1,586,897	\$1,497,169
Federal Special Revenue	\$135	\$1,679	\$1,754
Other	\$809	\$10,070	\$10,528
<b>Revenue:</b>			
General Fund	\$5,792,382	\$40,582,521	\$24,155,429
DPHHS – SSRA – Veteran’s Homes	\$357,031	\$2,142,187	\$2,058,233
Long-Range Building Program	\$6,132	\$36,792	\$6,724
<b>Net Impact on General Fund Balance:</b>	<b>\$5,788,174</b>	<b>\$40,541,948</b>	<b>\$24,113,857</b>

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| <input type="checkbox"/> Significant Local Gov. Impact<br><input type="checkbox"/> Included in the Executive Budget<br><input type="checkbox"/> Dedicated Revenue Form Attached | <input checked="" type="checkbox"/> Technical Concerns<br><input checked="" type="checkbox"/> Significant Long-Term Impacts<br><input type="checkbox"/> Needs to be included in HB 2 |
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## Fiscal Analysis

### ASSUMPTIONS:

#### **Individual Income Tax**

1. This bill revises the state’s individual income tax effective January 1, 2005 by:
  - a) capping the current full deduction for federal income taxes paid during the tax year at \$5,000 (\$10,000 if married and filing jointly);
  - b) revising the tax rate table to provide for a seven-tier rate table with marginal rates ranging from 1% to 6.9%; and
  - c) providing for a new tax credit equal to 1% of net capital gains (2% beginning in tax year 2007).
2. Under this bill, the current tax benefit rule continues to apply; that is, to the extent that taxpayers receive a tax benefit from the capped deductions for federal taxes provided for in this bill, they also will be required to report as income any portion of federal tax refunds previously included in the deduction. Capping the

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deduction in the manner provided for in this bill will significantly reduce the amount of income reported as federal income tax refunds in future years.

3. The bill provides for a new tax rate table for tax year 2005 which will be indexed for inflation in all future tax years.
4. Personal exemption and standard deduction amounts in current law are adjusted to accommodate a new base year from which adjustments to these items are calculated (tax year 2005). These adjustments result in personal exemption and standard deduction amounts that otherwise would occur under current law.
5. Based on the changes in the deduction for federal taxes, the new capital gains tax credit, and the new rate tables provided for in the bill, total individual income tax liability for all taxpayers is estimated to decrease by \$29,564,000 in tax year 2005 and by \$45,915,000 in tax year 2006 (DOR income tax simulation model).
6. The Department of Revenue will adjust withholding tables in tax years 2005 and 2006 to accommodate the reduction in tax liability, and taxpayers making quarterly estimated tax payments will do the same. Based on these assumptions, general fund collections are estimated to *decrease* by \$15,752,000 in fiscal year 2005, and by \$38,946,000 in fiscal year 2006

### **Accommodations and Campgrounds Tax**

7. Beginning June 1, 2003, this bill would impose a 3% tax on accommodations and campgrounds in addition to the existing accommodations tax
8. Taxable accommodations and campground rentals would be \$26.218 million in the one month of fiscal 2003 when the tax would be imposed on them. Tax liability would be \$787,000 (3% x \$26.218 million). Vendors would collect 95% of tax liability, or \$747,000.
9. Vendors would be allowed to retain 5% of collections as an administrative allowance with a limit of \$1,000 per quarter. In fiscal 2003, with the tax in effect for only one month, no vendors would reach the limit, and vendor allowances would be 5% of taxes collected by vendors, or \$37,000. Collections would be \$710,000 (\$747,000 - \$37,000)
10. In fiscal 2004, taxable accommodations and campgrounds charges would be \$319.495 million. Tax liability would be \$9.585 million (3% x \$319.495 million). Vendors would collect \$9.106 million (95% x \$9.585 million).
11. Beginning in fiscal 2004, there would be 35 vendors, accounting for 65% of taxable sales, for whom 5% of quarterly collections would be more than \$1,000. The total amount retained for vendor allowances in fiscal 2004 would be \$0.299 million (35 vendors x \$4,000 + 5% x 35% x \$9.106 million). Net collections to the general fund in fiscal 2004 would be \$8.806 million (\$9.106 million - \$0.299 million)
12. In fiscal 2005, taxable accommodations and campgrounds charges would be \$329.400 million. Tax liability would be \$9.882 million (3% x \$329.400 million). Vendors would collect \$9.388 million (95% x \$9.882 million).
13. Vendor allowances in fiscal 2005 would be \$0.304 million (35 vendors x \$4,000 + 5% x 35% x \$9.388 million). Net collections to the general fund in fiscal 2005 would be \$9.084 million (\$9.388 million - \$0.304 million).
14. State agencies would pay the tax on employee business travel. Expenditures would be 75% of current law accommodations tax expenditures. General fund expenditures would be \$2,563 in June of fiscal 2003, \$31,890 in fiscal 2004 and \$33,337 in fiscal 2005. Expenditures from state special revenue funds would be \$ 3,237 in fiscal 2003, \$40,282 in fiscal 2004 and \$42,110 in fiscal 2005. Expenditures from federal special revenue funds would be \$135 in fiscal 2003, \$1,679 in fiscal 2004 and \$1,754 in fiscal 2005. Expenditures from other funds, primarily agency proprietary funds, would be \$809 in fiscal 2003, \$10,070 in fiscal 2004 and \$ 10,528 in fiscal 2005.

### **Rental Vehicle Tax**

15. Beginning July 1, 2003, this bill would impose a 4% tax on the base rental charge for rental vehicles.

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16. In fiscal 2004, taxable rental vehicle charges would be \$60.396 million. Tax liability would be \$2.416 million (4% x \$60.396 million). Vendors would collect 95% of tax liability, or \$2.295 million.
17. Vendors would be allowed to retain 5% of collections as an administrative allowance with a limit of \$1,000 per quarter. No vendors would be over the limit, so that vendor allowances would be 5% of taxes collected by vendors. Collections would be \$2.180 million (95% x \$2.295 million).
18. In fiscal 2005, taxable rental vehicle charges would be \$62.268 million. Tax liability would be \$2.491 million (4% x \$62.268 million). Vendors would collect 95% of tax liability, or \$2.366. Vendors would retain 5% of taxes collected, and net collections would be \$2.248 million (95% x \$2.366 million).

### Cigarette Tax

19. The current law cigarette tax rate is \$0.18 per pack. Under this proposal, the cigarette tax rate is increased by \$0.52 to \$0.70 per pack.
20. Increasing the tax rate for two months in fiscal 2003 increases cigarette taxes by \$4,901,385. Based on the proposed law distribution percentages in the bill this would result in an *increase* in state general fund revenue of \$4,538,222; an *increase* in revenue to the long-range building program of \$6,132; and an *increase* in revenue to the Department of Public Health and Human Services for the operation and maintenance of state veterans' nursing homes of \$357,031 in fiscal 2003.
21. Under current law, cigarette tax revenues, after tribal revenue sharing payments, are distributed 73.04% to the state general fund; 15.85% to the long-range building program account; and 11.11% to the Department of Public Health and Human Services for the operation and maintenance of state veterans' nursing homes.
22. Under this proposal, cigarette tax revenues, after tribal revenue sharing payments, are distributed 8.3%, or \$2 million, *whichever is greater*, to the Department of Public Health and Human Services for the operation and maintenance of state veterans' nursing homes; 4.3% to the long-range building program account; and the remaining balance (87.4%) to the state general fund.
23. This proposal decreases the discount rates that wholesalers receive. The rates drop from 6% of the full face value of the insignia (tax) to 1.66% for the first 2,580 cartons purchased; from 4% to 1.11% for the next 2,580 cartons purchased; and from 3% to 0.83% for purchases in excess of 5,160 cartons.
24. Increasing the cigarette tax rate from \$0.18 to \$0.70 per pack, and decreasing the discount rates that wholesalers receive will generate net new revenue of \$29,408,311 in fiscal 2004, and \$28,351,795 in fiscal 2005.
25. Revenue to the state general fund will *increase* by \$27,229,332 in fiscal 2004 and by \$26,286,838 in fiscal 2005.
26. Revenue to the long-range building program account will *increase* by \$36,792 in fiscal 2004 and by \$6,724 in fiscal 2005.
27. Revenue to the Department of Public Health and Human Services for the operation and maintenance of state veterans' nursing homes will *increase* by \$2,142,187 in fiscal 2004 and by \$2,058,233 in fiscal 2005.
28. The above impacts are calculated using a model developed by the Department of Revenue (DOR). The Revenue and Transportation Committee (RAT) cigarette tax revenue estimate under current law for fiscal years 2004 and 2005 is used as the base. In addition to RAT's base estimate, a price elasticity of demand for cigarettes of 0.44 is used in this model. The model assumes the price of a pack of cigarettes will increase by the same amount (in dollars) of any tax increase. Given a base cost of \$3.21 per pack, which is used in this model, and an elasticity of 0.44, each penny increase in the price of a pack of cigarettes results in a decrease in demand of 0.14%.
29. The cigarette tax impacts provided for in this fiscal note include impacts associated with the price elasticity of demand for cigarettes, but do not include forecasts of declines in consumption of taxable cigarettes due to Internet sales of cigarettes, the impacts of current and future local government resolutions providing for non-smoking ordinances, or the effects of future increased tobacco prevention programs.

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**Tobacco Products Tax**

30. Under current law, all tobacco products other than cigarettes are taxed at a rate of 12.5% of the wholesale price. Under this bill, the tobacco products tax rate on all products other than “moist snuff” is increased to 25% of the wholesale price; the tax rate on moist snuff is raised from the equivalent of 28¢ an ounce to 35¢ an ounce.
31. Under current law and under this proposal, tobacco products tax revenues, after tribal revenue sharing payments, are distributed 100% to the state general fund.
32. Increasing the tobacco products tax rate from 12.5% to 50% of the wholesale price, and increasing the tax rate on moist snuff from the equivalent of 28¢ an ounce to 35¢ an ounce, will generate new general fund revenue of \$136,762 in fiscal 2003; \$820,574 in fiscal 2004; and \$833,532 in fiscal 2005.
33. The impacts in assumption ten are calculated using a model developed by the Department of Revenue (DOR). The Revenue and Transportation Committee’s tobacco products tax revenue estimate under current law for fiscal years 2004 and 2005 is used as the base. In addition to the base estimate, a price elasticity of demand for tobacco products of 0.44 is used in this model. The model assumes a 10% markup from the wholesale list price to the retail price.

**Transfers of Excess Fund Balances**

34. Amounts in excess of \$2 million in the state special revenue account for operation and maintenance of state veteran’s nursing homes are transferred to the general fund at the end of each fiscal year.
35. Excess revenues transferred to the general fund under this provision will be \$407,398 in fiscal year 2003, \$1,546,615 in fiscal year 2004 and \$1,455,059 in fiscal year 2005.

**Administrative Impacts**

36. The Department of Revenue’s new data processing system required by SB271 would be used to administer all the taxes affected by this bill. The data processing system costs associated with the changes in this bill are included in the fiscal note for SB271.
37. The department would require an additional 0.25 FTE for administration and compliance work for the rental vehicle tax. Additional personnel costs would be \$8,299 in fiscal 2004 and \$8,235 in FY05. The department also would incur setup costs for processing rental vehicle tax forms of \$384 in FY04.
38. In fiscal 2003, the department would send a mailing to all cigarette wholesalers explaining the procedures for changing the tax rate at a cost of \$1,625.

**FISCAL IMPACT:**

	<u>FY 2003</u>	<u>FY 2004</u>	<u>FY 2005</u>
	<u>Difference</u>	<u>Difference</u>	<u>Difference</u>
FTE		0.25	0.25

**Expenditures:**

Personal Services		\$8,299	\$8,235
Operating Expenses	\$1,625	\$384	\$0
Transfers	\$407,398	\$1,546,615	\$1,455,059
State Agency Sales Tax Payments	<u>\$6,743</u>	<u>\$83,921</u>	<u>\$87,728</u>
TOTAL	\$415,766	\$1,639,219	\$1,551,022

**Funding of Expenditures:**

General Fund (01)	\$4,188	\$40,573	\$41,572
State Special Revenue (02)	\$411,175	\$1,586,897	\$1,497,169
Federal Special Revenue (03)	\$135	\$1,679	\$1,754
Other	<u>\$809</u>	<u>\$10,070</u>	<u>\$10,528</u>
TOTAL	\$415,766	\$1,639,219	\$1,551,022

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Revenues:

General Fund (01)	\$5,792,382	\$40,582,521	\$24,155,429
State Special Revenue (02)			
Long Range Building Program	\$6,132	\$36,792	\$6,724
DPHHS - Veterans Home	\$357,031	\$2,142,187	\$2,058,233

Net Impact to Fund Balance (Revenue minus Funding of Expenditures):

General Fund (01)	\$5,788,194	\$40,541,948	\$24,113,857
State Special Revenue (02)			
Long Range Building Program	\$6,132	\$36,792	\$6,724
DPHHS - Veterans Home	\$(50,367)	\$595,572	\$603,174
Agency Sales Tax Payments	\$(3,237)	\$(40,282)	\$(42,110)
Federal Special Revenue (03)	\$(135)	\$(1,679)	\$(1,754)
Other	\$(809)	\$(10,070)	\$(10,528)

EFFECT ON COUNTY OR OTHER LOCAL REVENUES OR EXPENDITURES:

No impact.

LONG-RANGE IMPACTS:

Beginning with tax year 2007, the capital gains tax credit provided for in this bill increases to 2% of net capital gains reported on the taxpayer's income tax return. This is anticipated to increase the net reduction in tax liability by approximately \$7 million above what the reduction otherwise would be. The impacts from the increase in the accommodations tax, the new rental car tax and the increases in the cigarette and other tobacco taxes, combined with the estimated reductions in revenue from the individual income tax are estimated to result in a net **increase** in revenue of \$823,000 in fiscal 2006; and a net **decrease** in total revenues of \$(13,813,000) in fiscal 2007, and \$(17,021,000) in fiscal year 2008.

TECHNICAL NOTES:

1. If SB271 is not passed and approved, the Department of Revenue would need a new computer system to administer the rental vehicle tax. The costs for purchasing new software and having it customized would be \$1,195,305 in fiscal 2004. Office equipment and computers for contract programmers would be purchased in fiscal 2004 at a cost of \$11,124. Ongoing costs for software maintenance would be \$50,000 beginning in fiscal 2005. The department also would need to modify its existing income tax processing system in fiscal 2006. The costs for contract programming services would be \$6,365.